In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 74-1387

IRA M. LOWE, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The sole question raised by the petition is whether certain expenses of sale incurred by an estate were deductible for estate tax purposes under Section 2053(a) of the Internal Revenue Code of 1954.

Petitioners were co-executors of the estate of David Smith and also co-trustees of the testamentary trusts established by Smith's will for the benefit of his children. On May 23, 1965, Smith, a sculptor, died owning 425 pieces of sculpture which he had created. From the date of Smith's death until his estate was closed on August 21, 1973, petitioners sold a substantial amount of these sculptures and incurred selling expenses of $1,583,544.67. These expenses were approved by the

New York Surrogate's Court in an uncontested proceeding and petitioners deducted them in computing their federal estate tax liability as expenses of administration under Section 2053(a) of the Code.

Pursuant to Treasury Regulations, Section 20.2053-3 (d)(2), the Commissioner allowed a $750,447.74 deduction for the sales expenses incurred by petitioners, limiting the deduction to those sales that were necessary to raise enough cash to pay debts, other administration expenses, and taxes of the estate (Pet. App. B 32a-33a). The Tax Court upheld the Commissioner's determination. It found that the decedent's will "itself contemplated a distribution of the sculptures in kind to the trusts for the benefit of [his] daughters" (Pet. App. A 20a). Since neither the decedent nor his estate was under any obligation to support the daughters after the decedent's death, the Tax Court further found (*ibid.*) that to the extent that petitioners sold the sculptures placed in the daughters' trusts, "they were acting on behalf of the trust and not on behalf of the estate." It therefore held that the excess of petitioners' expenses of sale over $750,447.74 was incurred with respect to additional sales of sculpture which were not necessary either to preserve the estate or to effect distribution, but were made on behalf of the testamentary trusts (Pet. App. A 18a-22a).[1] A divided court of appeals affirmed (Pet. App. B 31a-41a).

1. The decision below correctly held that the expenses of sale were deductible only to the extent that they were related to the administration of the estate and not to the testamentary trusts. Section 2053(a) of the Code allows an estate tax deduction for "administration expenses * * * as are allowable by the laws of the juris-

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[1]During the period May 23, 1965, to April 30, 1970, petitioners distributed $1,448,429.44 in cash from the estate to the beneficiaries, the testamentary trusts and Smith's children (Pet. App. A 9a).

diction * * * under which the estate is being administered." Section 20.2053-3(a) of the Treasury Regulations defines the statutory term "administration expenses" as "limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate * * *."

More specifically, Section 20.2053-3(d)(2) of the Treasury Regulations provides that expenses of sale are deductible only to the extent the sale is "necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution." The Regulation is "prima facie proper, comporting as * * * [it does] with the ordinary understanding" of the term "administrative expenses." *Bingler* v. *Johnson*, 394 U.S. 741, 749, 751. See also *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501. Moreover, the Regulation has been in effect in substantially identical language since 1919[2] and is thereby "deemed to have received congressional approval and have the effect of law." *Helvering* v. *Winmill*, 305 U.S. 79, 83.

Contrary to petitioners' argument (Pet. 7-11), Section 2053(a) does not make allowance of an expense by the local probate court the sole criterion of deductibility. Of course, the allowability of an expense under state law is relevant in determining deductibility under Section 2053(a). But to be deductible for estate tax purposes, an expense must be of the "type intended to be deductible," which is ultimately a question of federal law. *United States* v. *Stapf*, 375 U.S. 118, 130. See also *Pitner* v. *United States*, 388 F.2d 651, 659 (C.A. 5); *Ballance* v. *United States*, 347 F.2d 419, 422 (C.A. 7).[3]

[2]See Treasury Regulations 37, Arts. 41, 44, promulgated under the Revenue Act of 1918.

[3]Petitioners argue (Pet. 10, 13) that *Ballance* v. *United States*, *supra*, supports their contention that state law controls the deductibility of estate administration expenses. Quite the contrary is the case. In holding that the taxpayer was not entitled to a deduction for administration expenses for interest paid on delayed federal estate tax

Pursuant to the Treasury Regulations, a deductible expense of estate administration is one which furthers the settlement of a decedent's estate, as distinguished from the expenses of administering other entities such as the testamentary trusts involved in this case. "[T]he carrying on of the trust is * * * for the benefit of the beneficiaries of the trust. It operates to continue the affairs of the living, not to close up those of the departed." *Sharpe's Estate* v. *Commissioner*, 148 F.2d 179, 181 (C.A. 3).

Thus, for example, in *Estate of Peckham* v. *Commissioner*, 19 B.T.A. 1020, the Board of Tax Appeals refused to allow any deduction for the expenses of maintaining and preserving the estate beyond the ordinary period of administration—in that case three years—because it found that after such time the executors were in fact holding the assets as trustees. Similarly, here, where part of the expenses were found to be attributable to the administration of the testamentary trusts and not to the administration of the estate, the decision below correctly disallowed the deductibility of that portion relating to the testamentary trusts. The expenses in question were not "administration expenses" of the estate within the meaning of the predecessor of Section 2053(a).

2. Petitioners argue (Pet. 11-14) that the decision below conflicts with *Estate of Park* v. *Commissioner*, 475 F.2d 673 (C.A. 6). There, an estate claimed a deduction under Section 2053(a) for expenses of selling real estate which had passed to the decedent's children under the residuary clause of her will. The children determined that they were not interested in retaining the properties and requested the executor to sell them. Relying on Treasury Regulations, Section 20.2053-3(d), the Tax Court (57 T.C. 705) concluded that the expenses in question were not deductible because the sale of the real estate was for the sole benefit of the beneficiaries and not to preserve the estate or effect distribution.

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payments, the Seventh Circuit rejected the view that state law controls. It noted (347 F.2d at 422) that the federal estate tax itself, while an allowable administration expense under Illinois law, was clearly not deductible under the predecessor of Section 2053(a).

The Sixth Circuit reversed. It held that the fact that Michigan law allowed the expenses to be charged against the probate assets governed their deductibility for federal estate tax purposes under Section 2053(a). In so concluding, the court invalidated Treasury Regulations, Section 20.2053-3(d), which provides that expenses of sale are deductible only to the extent the sale is "necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution." Moreover, the court in *Park* noted that the executor's decision to sell the real estate could be viewed as benefiting the estate regardless of the wishes of the beneficiaries.

Unlike *Park*, however, the decision below did not reach the question of the validity of the Regulation. The court of appeals noted (Pet. App. B 35a) that both Section 222 of the New York Surrogate's Court Act and Treasury Regulations, Section 20.2053-3, require an administrative expense to be "necessary" to the estate in order to be allowable. Moreover, like the Treasury Regulation, New York law characterizes the expenses in question as trust administration expenses rather than estate administration expenses.[4] See *Hurlburt* v. *Durant*, 88 N.Y. 121; *Johnson* v. *Lawrence*, 95 N.Y. 154; I Scott, *Law of Trusts* §6, p. 58 and n. 5 (3d ed., 1967). Finally, the fact that the decedent's will contemplated a distribution of the sculpture in kind to the daughters' trusts demonstrates that petitioners' sales of these items were done on behalf of the trusts and in their capacity as trustees and not as executors.

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[4]The fact that the New York Surrogate's Court allowed the sales expenses in an uncontested accounting is not determinative for purposes of deductibility under Section 2053(a). The surrogate did not characterize these expenses as estate administration expenses but simply allowed their payment by petitioners (Pet. App. A 8a). Indeed, even with respect to trust expenses, New York law required the surrogate to approve the accounts in order to insure that petitioners' actions were lawful in their capacity as trustees. See *Matter of McDowell*, 178 App. Div. 243, 164 N.Y.S. 1024; *Matter of Robinson*, 155 Misc. 855 (N.Y. Sur. Ct), 280 N.Y.S. 687. Thus, the surrogate's allowance cannot be regarded as a determination under state law for purposes of Sec-

Thus, this case does not present the purported conflict between state law and the Regulations which the Sixth Circuit perceived in *Park* and resolved in favor of state law. While *Park* concluded that "the expenses were admittedly allowable under Michigan law" (475 F.2d at 676), petitioners did not, and could not, demonstrate that the uncontested expenses approved by the surrogate were allowable as estate administration expenses rather than as trust administration expenses under New York law. As the court of appeals observed (Pet. App. B 37a), it was "unnecessary [for it] to pass on whether Treas. Reg. §20.2053-3(d)(2) is invalid if read to deny a deduction properly allowed by state law."[5]

Contrary to petitioners' assertion (Pet. 10), there is no conflict with *Union Commerce Bank* v. *Commissioner*, 339 F.2d 163 (C.A. 6). That case dealt with the deductibility as an administrative expense of post-death interest on overdue gift tax obligations. The court did not regard as dispositive the fact that such an expense is not covered in Treasury Regulations, Section 20.2053-3, but relied upon Ohio law and remanded the case to the Tax Court for additional evidence as to how the expense was treated by the local probate court (339 F.2d at 167-168). However, the apparent allowance of such an expense under Ohio law, coupled with the silence of the Treasury Regulations, effectively distinguishes that case from the decision below, where both the state law and the Treasury Regulations characterized the expense in question as not incurred on behalf of the estate.

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tion 2053(a). Moreover, where a portion of these expenses were incurred on behalf of the testamentary trusts and not the estate, the federal courts are not precluded from reexamining a lower state court's allowance of administration expenses. See *Commissioner* v. *Estate of Bosch*, 387 U.S. 456. Treasury Regulations, Section 20.2053-1(b)(2).

[5]Petitioners' reliance (Pet. 10, 13) upon *Commercial Nat. Bank of Charlotte* v. *United States*, 196 F.2d 182 (C.A. 4), is similarly misplaced. Like the decision below, the court did not find it necessary to decide the question whether the allowability of an administrative expense under state law was determinative for federal estate tax purposes because the costs involved were not allowable under state law.

Finally, the decision below does not conflict with *Dulles* v. *Johnson*, 273 F.2d 362 (C.A. 2) (Pet. 11). There, the court permitted deductions as administration expenses of fees paid by the estate to lawyers who represented various legatees in estate litigation commenced by the executors in state courts. The litigation involved the questions whether a charitable beneficiary was a functioning organization and whether estate taxes were to be paid prior to the establishment of a residuary estate. Pursuant to orders of the New York appellate courts and the New York Surrogate's Court, the estate paid the legal fees of all of the parties.

Unlike this case, where the estate's claim to a deduction rests upon an uncontested allowance by the probate court of expenses which were properly classifiable under New York law as trust expenses, the court in *Dulles* found that the legal fees were paid "pursuant to a court order required as a direct and unavoidable result of the proceedings instigated by [the executors] to construe the will they were to administer" (273 F.2d at 369-370). As such, they were deductible administration expenses under Section 2053(a), since they were "attorney's fees" "essential to the proper settlement of the estate * * *." Treasury Regulations, Section 20.2053-3(a).

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

JULY 1975.